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PASS TREASURY, FEDERAL RESERVE, COMMERCE

E. O. 11652: N/A

TAGS: EFIN, FR

SUBJECT: GOF ECONOMIC POLICY IN TRANSITION

REF: (A) PARIS 12570; (B) PARIS 13165

1. SUMMARY: THE RISE IN THE BANK OF FRANCE REDISCOUNT RATE FROM 8 TO 9.5 PERCENT AND CORRESPONDING CHANGES IN MONEY MARKET RATES REPRESENT A SIGNIFICANT CHANGE IN MONETARY POLICY. THIS CHANGE PROBABLY WILL BE FOLLOWED BY CHANGES IN FISCAL, WAGE AND BUSINESS POLICIES DESIGNED TO IMPROVE PRICE PERFORMANCE WHILE SUSTAINING THE BASIS FOR BETTER BALANCED ECONOMIC GROWTH IN 1977.

HARD DECISIONS AND CONSISTENT POLICIES WILL BE NEEDED TO ACHIEVE THESE OBJECTIVES. THE GOVERNMENT'S PROGRAM PROBABLY WILL NOT BE REVEALED UNTIL EARLY SEPTEMBER

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AFTER THE CURRENT VACATION PERIOD ENDS, BUT GOF

ECONOMIC POLICY CLEARLY IS MOVING TOWARD TIGHTER
MONETARY AND FISCAL POLICIES PROBABLY SUPPLEMENTED
BY SOME FORM OF GUIDELINES POLICY FOR PRICES AND WAGES.
END SUMMARY

2. AS REPORTED IN REFTEL A, MONETARY POLICY HAS BEEN
PASSIVE AND ALIGNED TO FOREIGN EXCHANGE POLICY. THUS,
WHEN THE FRANC CAME UNDER PRESSURE THREE WEEKS AGO,
PARTLY BECAUSE OF MARKET EXPECTATIONS BUT ALSO BECAUSE
THE AUTHORITIES WISHED TO USE SEASONAL FACTORS TO
ACHIEVE A MARKET LED DEPRECIATION OF THE FRANC,
MONETARY POLICY WAS TIGHTENED IN ORDER TO KEEP FOREX
MARKET SPECULATION FROM GETTING OUT OF HAND. LOOKING
BEYOND THE FOREX MARKET, A TIGHTER MONETARY POLICY
ALSO IS INTENDED TO SLOW THE RAPID RATE OF MONETARY
EXPANSION, CURRENTLY RUNNING IN EXCESS OF 17 PERCENT.
AN ANNUAL RATE BETWEEN 12 AND 13 PERCENT FOR THE REST
OF 1976 WILL BE NECESSARY IN ORDER TO ACHIEVE THE
ORIGINAL TARGET OF BETWEEN 14 AND 15 PERCENT FOR THIS
YEAR. OTHER MAJOR POLICY MEASURES ARE NO LONGER
AVAILABLE THIS YEAR. FISCAL DECISIONS TAKEN IN APRIL
MEANT A LARGE BUDGET DEFICIT WHICH HAS BEEN THE
LEADING EDGE OF THE EXCESSIVE RATE OF MONETARY EXPAN-
SION, AND DECISIONS TAKEN EVEN EARLIER HAVE ASSURED
ANOTHER ROUND OF LARGE REAL WAGE INCREASES. (SEE
REFTEL B FOR DETAILS.) WITH MOST FORECASTS NOW
ENVISIONING AN INFLATION RATE OF BETWEEN 11 AND 12
PERCENT, A TIGHTER MONETARY POLICY PROBABLY CAN
PREVENT AN EVEN WORSE RATE AND MAY HELP BRING IT CLOSER
TO 10 PERCENT. BUT IN THE CONTEXT OF GOF ECONOMIC
POLICY FOR 1977, A TIGHTER MONETARY POLICY IN
THE SECOND HALF OF 1976 IS THE ESSENTIAL PRECONDITION
FOR BETTER PRICE PERFORMANCE NEXT YEAR. WHETHER THIS
OBJECTIVE PLUS CONTINUED ECONOMIC GROWTH CAN BE ACHIEVED
IN 1977 ALSO DEPENDS UPON OTHER ACTIONS, CHIEFLY FISCAL
AND WAGE POLICIES AND ABOVE ALL A GREATER DEGREE OF
CONSISTENCY AND COORDINATION THAN HAS BEEN EVIDENT SO
FAR IN GOF ECONOMIC POLICY (SEE REFTEL B).

3. MEANWHILE THE GOVERNMENT IS DEVELOPING A SERIES OF
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MEASURES, RANGING FROM REVALUATION OF COMPANIES BOOKS
FOR TAX PURPOSES SO AS TO REDUCE INFLATIONARY INCREASES
IN TAX LIABILITIES TO SOME FORMS OF SOCIAL CONTRACTS
FOR PROFITS AND INDIRECTLY WAGES. PRIME MINISTER
CHIRAC HAS MENTIONED A "CARROT AND STICK" APPROACH
TO CONTROL PRICE INCREASES. THIS SUGGESTS SOME COMBINA-
TION OF FISCAL INCENTIVES AND PENALTIES BASED ON SOME
SET OF PRICE AND INCOME BEHAVIOR WHICH WAS THE BASIC

CONCEPT OF THE "ANTI-INFLATION LEVY" WHICH WENT INTO
EFFECT IN APRIL 1975. THIS LEVY HAS NEVER BEEN USED.
(SEE PARIS AIRGRAM 25778 OF MAY 12, 1975, FOR DETAILS.)
POSSIBLY THE "ANTI-INFLATION LEVY" OR SOME ASPECT OF
IT WILL BE USED TO GIVE TEETH TO WHATEVER GUIDELINES
EMERGE. FOR EXAMPLE, IT COULD BE RELATED TO REVALUA-
TION OF COMPANY BOOKS FOR TAX PURPOSES, SINCE THE CLAIM
FOR TAX ADJUSTMENT BASED ON INFLATION COULD BE THE BASIS
OF AN "INFLATION LEVY" IF CERTAIN GUIDELINES WERE BROKEN.

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4. THE GOVERNMENT IS PREPARING THE 1977 BUDGET FOR
PRESENTATION IN THE FIRST OR SECOND WEEK OF SEPTEMBER.
IN ITS DRAFT FORM IT IS BALANCED AND CALLS FOR NO
EXPENDITURE INCREASES IN REAL TERMS EXCEPT FOR THE

POST, TELEPHONE AND TELEGRAPH INVESTMENT PROGRAM AND DEFENSE SPENDING REFLECTING INCREASED PAY AND OTHER BENEFITS FOR SERVICEMEN. NO TAX INCREASE IS ENVISIONED. SINCE CURRENT EXCESSIVE MONETARY EXPANSION IS MAINLY A FUNCTION OF THIS YEAR'S LARGE BUDGET DEFICIT, FISCAL BALANCE IN 1977 WILL BE A KEY ELEMENT IN ACHIEVING BETTER PRICE PERFORMANCE. THIS YEAR'S BUDGET ALSO WAS SUPPOSED TO BE IN BALANCE, SO THERE REMAINS SOME ROOM FOR SKEPTICISM. HOWEVER, ASSUMING THAT THE EFFECTS OF THE DROUGHT THIS YEAR ARE NO MORE SERIOUS THAN CURRENTLY FORECAST--10 BILLION FRANCS ON GROSS LIMITED OFFICIAL USE

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DOMESTIC PRODUCT BASIS--A BALANCED BUDGET IN 1977 SEEMS POSSIBLE.

5. WHATEVER VARIATION OF INCOMES POLICY, OR ANTI-INFLATION LEVY, OR SOCIAL CONTRACT THE GOF MAY DISCLOSE THIS FALL, THE CRUX WILL BE WAGE POLICY. SINCE 1968 REAL WAGES HAVE BEEN INCREASED CONSIDERABLY EACH YEAR WITHOUT REGARD TO EITHER PRODUCTIVITY OR BUSINESS CYCLES, NOT EVEN DURING THE SEVERE RECESSION OF 1974-75 WHEN THEY ROSE AT ABOUT THE SAME RATE AS IN THE BOOM THAT PRECEDED THE RECESSION. MOREOVER, THESE INCREASES CAUSE INCREASED FRINGE BENEFITS AND SOCIAL SECURITY PAYMENTS THAT AVERAGE OVER 40 PERCENT OF TOTAL WAGES. POSSIBLY THE GOF HAS BOUGHT GREATER LABOR PEACE AND MORE STABLE SOCIAL AND POLITICAL CONDITIONS THAN WOULD HAVE EXISTED OTHERWISE BY ITS WAGE POLICY, BUT IN TERMS OF CONTROLLING UNDERLYING PRICE PRESSURES, IT MUST BE MODERATED. IF NOT, IMPROVED PRICE PERFORMANCE WILL REMAIN UNATTAINABLE, EXCEPT POSSIBLY AT A VERY LOW RATE OF REAL ECONOMIC GROWTH WITH A HIGH LEVEL OF UNEMPLOYMENT. IN SHORT, THE LAST AND POSSIBLY MOST CRUCIAL STEP IN THE CURRENT TRANSITION OF GOF ECONOMIC POLICY WON'T BE TAKEN UNTIL EARLY NEXT YEAR WHEN THE GOVERNMENT BEGINS NEGOTIATIONS WITH UNIONS REPRESENTING THE PUBLIC SERVICE AND THE NATIONALIZED SECTOR. THE PATTERN OF RECENT YEARS HASN'T BEEN VERY REASSURING IN THIS RESPECT. AS FOR 1976, SEVERAL LABOR LEADERS HAVE NOTED THAT CONTRACTS HAVE BEEN SIGNED, THAT THE UNIONS INTEND TO LIVE UP TO THEM AND THAT THEY CAN'T UNDERSTAND ALL THIS TALK ABOUT SOCIAL CONTRACTS.

6. AS SUGGESTED ABOVE THE PUBLIC SECTOR (CIVIL SERVICE AND NATIONALIZED COMPANIES) IS THE ONLY AREA IN WHICH GOF CAN IMPOSE WAGE RESTRAINTS BECAUSE THIS IS THE ONLY AREA SUBJECT TO NATIONWIDE COLLECTIVE BARGAINING AND GOF CONTROL. AT THE TIME OF SIGNATURE OF 1976 AGREEMENTS EARLY IN THE YEAR,

GOF INTIMATED THAT THE TIME TO MODERATE REAL WAGE
INCREASES FOR ALL EXCEPT FOR THOSE AT THE BOTTOM
OF THE WAGE SCALES HAD COME AND WARNED THAT 1977
NEGOTIATIONS MAY BE MORE DIFFICULT. UNION LEADERS
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HOWEVER AND ESPECIALLY THOSE OF THE MODERATE UNIONS
LIKE BERGERON OF FO CONTINUE TO COUNT ON GOF GIVING
HIGHER PRIORITY TO POLITICAL BENEFITS OF SUCCESSFUL
NEGOTIATIONS THAN TO ECONOMIC BENEFITS OF A FIRM WAGE
RESTRAINT.

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7. DIRECT GOF INTERVENTION OR INFLUENCE IN PRIVATE SECTOR WAGE SETTLEMENTS IS LIMITED IF NOT NON-EXISTENT. THE BASIC HANDICAP IS THE ABSENCE OF A MECHANISM OF NATIONWIDE OR EVEN REGIONAL COLLECTIVE BARGAINING BETWEEN UNIONS AND MANAGEMENT ASSOCIATIONS. SUCH NATIONAL OR REGIONAL COLLECTIVE BARGAINING AS IT MAY EXIST IS LIMITED TO SETTING THE FLOOR ON MINIMUM WAGES AND NOT THE CEILING. THEREFORE, THE ONLY ALTERNATIVE FOR GOF IS TO DEVISE CARROTS AND STICKS WHICH WOULD LIMIT EMPLOYERS' TENDENCY OF THE LAST FEW YEARS TO MAKE WAGE SETTLEMENTS GENERALLY IN EXCESS OF THOSE IN PUBLIC SECTOR.

8. REFTTEL B PARA 5 WAS TITLED: "CAN GISCARD'S LIBERAL SOCIETY CONTROL INFLATION AND BALANCE ECONOMIC GROWTH?" LIMITED OFFICIAL USE

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EVENTS IN THE COMING MONTHS ARE MOVING TOWARD THE SEVERE TEST FOR THE GOF AND GISCARD'S ECONOMIC LEADERSHIP DISCUSSED IN REFTTEL B. THE MONETARY MEASURES RECENTLY TAKEN WERE ALSO TAKEN IN 1974. THE QUESTION IS WHETHER OR NOT THIS NECESSARY BEGINNING STEP WILL BE CONSISTENTLY FOLLOWED THROUGH AND COORDINATED WITH OTHER KEY ECONOMIC POLICIES SO AS TO ACHIEVE IMPROVED PRICE PERFORMANCE AND BALANCED ECONOMIC GROWTH. AS OUTLINED IN REFTTEL B, THE GOF ALREADY HAS LOST EIGHTEEN MONTHS IN THIS EFFORT MAINLY AS THE RESULT OF POORLY TIMED DECISIONS; E.G., THE ECONOMIC SUPPORT PROGRAM; OR ILL CONSIDERED DECISIONS, E.G., REJOINING THE EC "SNAKE". GIVEN THE USUAL LAG BETWEEN POLICY CHANGES AND ECONOMIC PERFORMANCE, THE GOF HAS ONLY ONE YEAR LEFT TO GET THE ECONOMY RIGHT BEFORE THE LEGISLATIVE ELECTIONS IN 1978. THUS THE OUTCOME OF ECONOMIC POLICY DECISIONS THIS FALL COULD HAVE A STRONG INFLUENCE ON THE NATIONAL ASSEMBLY ELECTIONS IN 1978. GAMMON

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